American Bankers Association
Building Success. Together.

Francisca N. Mordi
Vice President & Senior Tax Counsel
(202) 663-5317
fmordi@aba.com

September 20, 2011

The Honorable Douglas Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Waiver of Penalty Relating to Compliance with The New Merchant Reporting Rule Under Section 6050W

Dear Commissioner Shulman

The American Bankers Association (ABA) requests that the Internal Revenue Service (IRS) provide a waiver of penalties for the first year for failures relating to reporting and withholding under the new merchant reporting rules under section 6050W where there is a showing of good faith efforts to comply with the rules. The ABA recognizes the significant challenges that the IRS faced in developing workable and meaningful regulations that provide the guidance necessary for implementing the new section 6050W, and we commend the IRS for the efforts in trying to publish such important guidance prior to the compliance deadline. Despite the issuance of final guidance, it is important to note that the new rules create enormous compliance issues that will be difficult to resolve within the short turnaround time for compliance. The combination of the short time for compliance (i.e., additional final guidance was issued shortly before compliance due date) and the broad scope of compliance concerns that abound in this area, we anticipate that it is highly likely that there will not be a smooth transition during the first year of implementation. Notwithstanding best efforts to get the necessary compliance systems and processes up and running, we believe there will be missing information and/or error rates that are unacceptable to either the IRS or the industry.

Section 6050W imposes significant new burdens and implementation challenges on the industry. For the reasons addressed later in this letter, we are requesting: (a) that the IRS formally provide penalty relief for tax reporting year 2012 for persons who have made good-faith efforts to implement and comply with the section 6050W reporting and backup withholding requirements, and (b) that the IRS consider a one year delay in the implementation of the backup withholding rules.

The banking industry has been working at great cost since enactment of the provision in 2008, to design, build and test new systems that will collect TINs from millions of merchants, report monthly and annual gross payments to these merchants on the new Form 1099-K, and withhold on payments to merchants in the event of missing or invalid TINs. Despite these best efforts, it is not unreasonable to expect that there will be some difficulties in the collection of accurate and timely information with respect to merchant legal names and TINs, which will result in the inability by payment settlement entities (PSEs) to file correct information returns and furnish correct payee statements. Imposition of penalties in 2012[1] will create additional problems for filers, particularly those that have made a good faith effort especially considering the short time period allowed to obtain the necessary data.

[1] PSEs will first be required to file Forms 1099-K in 2012 (for the 2011 year) and must begin backup withholding on merchant payments in the absence of valid TINs.

Factors contributing to these compliance hurdles revolve mostly around design issues relating to new systems and procedures that had to be built to accommodate the new reporting and withholding rules, as well as the processes that will be required because of the IRS's continuing issuance of guidance . Final IRS regulations under section 6050W were published just four months before the January 1, 2011 effective date of the provision, giving the industry insufficient time to build and test systems that will accurately capture reportable data. Moreover, industry questions and confusion over several issues continue to linger, including the definition of "transaction date." Further, the IRS just last month issued new rules adjusting the process by which the foreign status of merchants could be established. Although these new rules are generally intended to respond to taxpayer concerns, they add new steps that were not previously included in the final regulations, and they cannot be incorporated into filers' new compliance systems in time for the filing the Form 1099-K for calendar year 2011.

The fact that the IRS has amended the Form 1099-K as late as this month (nine months into the effective date of the new rules) further compounds the compliance problems the industry is facing. After the IRS released the 2011 Form 1099-K in February 2011, the industry has been working to build reporting platforms that can generate the requested information. This month, after all those months of work by the industry, the IRS revised the form by adding a new information field (i.e., Box 2, which requires banks to enter merchant category codes – a requirement not included in the February version of the form). Because this requirement was not included in the earlier version, it is very likely that neither banks nor their third party processors are capturing this information in the systems that they have designed to begin filing 2011 Forms 1099-Ks beginning in 2012. This new information field cannot be added to the already built reporting systems in time for the industry to be able to capture and accurately report the required information in 2012.

In a July 2011 report ("Plans for the Implementation of Merchant Card Reporting Could Result in Burden for Taxpayers and Problems for the Internal Revenue Service"), Treasury Inspector General for Tax Administration (TIGTA) highlighted the implementation challenges inherent in the new section 6050W. In the report, TIGTA identified the serious compliance problems the industry faces with the new rules, raised concerns about the IRS's readiness to administer the provision, and pointed to the risk that TIN mismatches would not be resolved before backup withholding takes effect. On this latter point, it is significant to note that the TIGTA report incorrectly assumed that backup withholding under section 6050W does not take effect until 2013 – one year later than is actually the case. Under the new rules, back up withholding takes effect in 2012. If the report raised concerns regarding backup withholding while incorrectly assuming that it takes effect in 2013, one assumes TIGTA would have raised even stronger alarms had it understood that backup withholding must begin less than six months from the report's publication.

Because of these implementation and compliance difficulties that the industry is facing, as well as the timing of the release of guidance, we request that the IRS formally provide penalty relief for tax reporting year 2012 for persons who have made good-faith efforts to implement and comply with the section 6050W reporting and backup withholding requirements.

Our request for penalty waiver is consistent with the IRS's statement in the preamble to the final section 6050W regulations that penalties will be "mitigated" in the early stages of implementation, "except for particularly egregious cases." However, as the IRS did not specifically explain or describe what would be considered a "particularly egregious" case or how general penalty relief under section 6724 might be applied with respect to section 6050W (e.g., relief under section 6724 would generally require the showing of "significant mitigating factors" or "events beyond the filer's control"), we recommend that the IRS issue guidance waiving penalties with respect to section 6050W for 2012 (i.e., the first year of reporting and withholding with respect to payments made to merchants during calendar year 2011) if the

PSE or other filer shows it has made a good-faith effort to comply with the requirements. This will help alleviate industry concerns. Moreover, similar formal relief has been provided in comparable instances (e.g., IRS Notice 2003-67 relating to information reporting of payments in lieu of dividends), and we believe that this approach is entirely consistent with the view reflected in the preamble to the final section 6050W regulations that penalties should be imposed only in exceptional circumstances.

In addition to our request that the IRS formally provide penalty relief for persons who have made good-faith efforts to comply with the information reporting rules under section 6050W, we strongly urge the IRS to consider a one year delay in the implementation of the related backup withholding rules. This is advisable in light of the risk of a significant number of TIN mismatches in the early stages of operation. As discussed above, the TIGTA report raised serious concerns about the potentially broad reach of backup withholding at the outset of implementation (noting that the TIGTA report mistakenly assumed that industry, merchants, and the IRS would have until 2013 to resolve TIN mismatches before backup withholding kicked in). Absent a delay in withholding, which the IRS has provided in comparable circumstances (e.g., most recently in the case of withholding under section 3402(t) on certain payments by government entities), we are concerned about the impact not only on PSEs, but more importantly, on merchants who will be deprived of potentially critical funds while TIN mismatches are resolved. At a time when many small businesses are struggling to rebound from the recent economic crisis, having 28 percent withheld from merchant and third party network gross payments could cause permanent damage, including a situation where some merchants are forced to cease operations. Moreover, we believe that delaying backup withholding would not interfere with the IRS's ability to collect merchant transaction data reported pursuant to 6050W.

Thank you for your consideration of these views. Please feel free to contact me at fmordi@aba.com or 2020.663.5317 if you would like to discuss this issue further or have any questions.

Sincerely,

Fran Mordi
Vice President & Senior Tax Counsel

cc: Girish Prasad
Office of Chief Counsel
cc: PA: 01
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224